

CORPORATIONS COMMITTEE  
BUSINESS LAW SECTION  
THE STATE BAR OF CALIFORNIA  
180 HOWARD STREET  
SAN FRANCISCO, CA 94105-1639  
[www.calbar.org/2sec/3bus/2busndx.htm](http://www.calbar.org/2sec/3bus/2busndx.htm)

December 16, 2002

VIA E-MAIL: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

re: SEC File Nos. S7-45-02; 33-8150.wp  
Release Nos. 33-8150; 34-46868; IC-25829  
Proposed Rules under Section 307 of the Sarbanes-Oxley Act of 2002  
"Implementation of Standards of Professional Conduct for Attorneys"

Dear Mr. Katz:

We are writing to comment on the above-referenced release and proposal (the "Release") issued by the Securities and Exchange Commission (the "Commission") in connection with Section 307 of the Sarbanes-Oxley Act of 2002 (the "Act"). These comments are provided on behalf of the Business Law Section of the State Bar of California (the "Business Law Section") by the Corporations Committee (the "Committee") of the Business Law Section. Please note that positions set forth in this letter are only those of the Business Law Section. As such, they have not been adopted by either the State Bar's Board of Governors, its overall membership, or the overall membership of the Business Law Section, and are not to be construed as representing the position of the State Bar of California. The Business Law Section is composed of attorneys regularly engaged in advising business enterprises in California; the Committee is composed of attorneys regularly advising California corporations and out-of-state corporations transacting business in California. **Membership in the Business Law Section, and on the Committee, is voluntary and funding for activities of them, including all legislative activities, is obtained entirely from voluntary sources. There are currently more than 16,000 members of the Business Law Section.**

California is home to a significant number of issuers and securities counsel. As the largest jurisdiction in the country, California is affected perhaps more than any other state by the rules proposed in the Release to be added as new Part 205 of Title 17, Chapter II, of the Code of Federal Regulations (in the form set forth in the Release, the "Proposed Rules"; in the form ultimately adopted, the "final Rules"). This letter addresses issues arising under the Proposed Rules that we have identified as having specific conflicts with California law and the obligations

of attorneys practicing in California. We expect the Release to draw significant comments from attorneys practicing in other jurisdictions. For purposes of better focusing our comments, we have omitted discussion of other issues arising under the Proposed Rules, such as the scope of the definition of "practicing before" the Commission, with the expectation that comments on such issues will come from other commentators.

## **I. SUMMARY**

We believe that the Proposed Rules have many useful conceptual components which could enhance compliance by issuers with the various federal securities laws. Those may also enhance investor confidence in the integrity of public markets in the United States. Nonetheless, we have specific concerns about the Proposed Rules. Those include:

1. The Proposed Rules conflict with California law and the rules of conduct adopted by the California Supreme Court. This conflict is particularly acute in the case of the "noisy withdrawal"<sup>1</sup> and mandatory disaffirmance requirements of the Proposed Rules (the "reporting out" provisions).<sup>2</sup> In addition, we believe that the Proposed Rules may be in conflict with statutory and court rules in other jurisdictions. We recommend that the Proposed Rules avoid direct conflict with the existing California statutes and rules governing attorney conduct. We believe that the goals and purposes of Section 307 of the Act can be met -- and, in fact, will be promoted by avoiding such conflict.
2. The conflict between the Proposed Rules and California law is unnecessary, since it stems from a portion of the Proposed Rules (the "noisy withdrawal" and mandatory disaffirmance requirements) that departs from both the letter and spirit of the Act. The Act provides no express authority for the Commission to adopt "reporting out" or disaffirmance provisions in conflict with state laws. As a result, the conflicts between the Proposed Rules and state law requirements on attorney conduct are likely to be litigated in a variety of different fora. Protracted litigation and potentially inconsistent decisions will adversely affect investor confidence. We recommend that the Commission narrow the scope of the final Rules to eliminate the substantial uncertainties created by the text of the Proposed Rules.
3. Doctrines and rules pertaining to privilege, admissibility, and duties of attorneys practicing in California are governed by California and federal law, including the securities laws. Although the Proposed Rules may purport to address these doctrines and rules, it is unclear that the Commission can impose its interpretation of them in contexts not involving the Commission. That lack of clarity will create a risk of protracted litigation and potentially inconsistent decisions.

4. The specific requirements under Section 307 of the Act that an attorney "report up" the corporate ladder on material violations of securities law establish a mechanism assuring that close or controversial legal issues are exposed to the scrutiny of independent directors. To achieve the benefits of "reporting up," however, it is not necessary -- and, in fact, is harmful -- to involve attorneys in "reporting out" to the Commission or the public. Such requirements are likely to impair the effective assistance of counsel, converting attorneys from advisors and advocates for their clients into quasi-regulators and judges of their clients. We do not believe that Congress intended such a fundamental realignment of responsibilities when it enacted Section 307. Further, such a change in the role of counsel undermines the purpose of Section 307, which is to promote (not discourage) access to legal advice by the proper levels of management.

The Proposed Rules contain the concept of the qualified legal compliance committee ("QLCC"), a body constituted within the issuer's Board of Directors and made up of independent directors, which will have the authority and the responsibility to investigate and take action of securities compliance questions. An attorney who reports concerns over securities law compliance to the QLCC has discharged his or her responsibilities and need not "report out." We recommend that the final Rules specify that an attorney who "reports up" to either a QLCC or the entire Board of Directors have no "reporting out" obligation under the Act and the final Rules. In that way, the specific requirements and goals of Section 307 of the Act will have been achieved, and conflicts with state law regarding attorney responsibility need not arise.

## II. DISCUSSION

### A. THE CONTEXT AND OBJECTIVES OF SECTION 307 OF THE ACT

The Act, which regulates a broad set of activities involving public companies, was adopted following months of scandal in which previously undisclosed financial problems with public issuers came to light. News reports and attorney work-product made public in those matters appear to contain examples of executives who (i) were uninformed of the existence or potential consequences of critical activities and practices within the company, (ii) used such lack of awareness as a defense to allegations of their own misconduct, or (iii) both. According to the Release, the amendment offered to pending legislation which ultimately became Section 307 of the Act was a direct result of Senator Edwards' concern that improper -- and generally overly limited -- use of legal advice had contributed to executives pleading ignorance of material problems and legal obligations.

The "reporting up" provisions in Section 307 of the Act address such failures directly by mandating that, in connection with preparing rules on the "minimum standards" for professional conduct before the Commission, the Commission include a rule requiring an attorney to report evidence of material legal issues up the chain of command in an issuer.

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

SUBMITTED BY E-MAIL

Fulfillment of these "reporting up" provisions under the Act would significantly diminish any reasonable basis for management to assert ignorance of legal issues or the consequences of controversial actions, by bringing increased scrutiny to controversial or close legal decisions. Management personnel (and attorneys) who know they must justify a controversial recommendation or decision to, and gain the agreement of, a company's independent directors may well decide against advancing narrow, technical interpretations of the law that promote management self-interest but not necessarily the best interests of the corporation.

Where the Proposed Rules address and promote the receipt by the appropriate levels of management -- up to and including the board of directors -- of legal advice, we believe the Proposed Rules promote the purposes of the Act and the securities laws generally. And they contribute to increased compliance with the law. The "reporting out" provisions, however, by discouraging corporate insiders from seeking advice in the first place, undermine this goal. Frankly, by eliminating a "reporting out" obligation if a QLCC is formed, the Commission has acknowledged that the "reporting out" obligation is not necessary to carry out the intent of Section 307. Without commenting on whether or not QLCCs should be encouraged, we believe that an attorney's ethical duties should not turn on whether or not a report is made to the full board (including independent directors) or to a QLCC.

**B. CONGRESS INTENDED LIMITED SCOPE FOR SECTION 307 OF THE ACT**

Section 307 of the Act does not give the Commission the authority to pre-empt state laws relating to attorney-client confidences, withdrawals, or waivers of privilege. The text of Section 307 of the Act does not support the Proposed Rule's requirements of noisy withdrawal and disaffirmance. Beyond the specific "reporting up" requirements, Section 307 of the Act directed the Commission to:

"issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission."

The legislative history of the Act reinforces that it should be read in a limited fashion. As the Commission noted at footnote 57 to the Release, Senator Enzi stated in the debate over Section 307 that it "would *not* require attorneys to report violations to the SEC." (emphasis added) An expanded report of Senator Enzi's remarks makes the limited intent of Section 307 even more plain:

"The amendment I am supporting would not require the attorneys to report violations to the SEC, only to corporate legal counsel or the CEO, and ultimately, to the board of directors.

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

SUBMITTED BY E-MAIL

"Some argue that the amendment will cause a breach of client/attorney privilege, which is ludicrous. The attorney owes a duty to its client which is the corporation and the shareholders. By reporting a legal violation to management and then the board of directors, no breach of the privilege occurs, because it is all internal-within the corporation *and not to an outside party, such as the SEC* [emphasis added].

"This amendment also does not empower the SEC to cause attorneys to breach their attorney/client privilege. Instead, as is the case now, attorneys and clients can assert this privilege in court."

148 Cong. Rec. S6555. *See also* comments of Senator Corzine at 148 Cong. Rec S6556.

In other words, Congress wanted to have attorneys obligated to "report up," but not to "report out," as the noisy withdrawal and disaffirmance elements of the Proposed Rules would require. Congress certainly knew how to require "reporting out" had they wanted to: Section 10A of the Securities Exchange Act of 1934, as amended, requires such reporting out by accountants. Congress knew, however, that the role of counsel differs profoundly from that of an accountant, and therefore consciously stopped short of limiting in any way the traditional confidentiality that has marked the relationship between attorney and client. The Commission itself noted in the Release that "[p]roviding notification to the Commission, however, goes beyond what the Act expressly directed the Commission to do." Worse, it does just what the sponsors of Section 307 said it would not do.

We recognize that the Commission staff asserts the power to preempt state law relating to matters covered by the Proposed Rules. We also note, however, that the Supreme Court has repeatedly held that the intent to preempt state law must be clearly manifested by Congress.<sup>3</sup> *See, Reid v. Colorado*, 187 US 137, 148 (1902); *Sprietsma v. Mercury Marine*, 2002 US Lexis 9067, at \*32 (decided December 3, 2002). Both the language of Section 307 and the legislative history of the Act demonstrate that, whatever one thinks of the wisdom of the Commission's "noisy withdrawal" and disaffirmance proposals, Congress has hardly expressed a manifest intent to preempt contrary state rules, such as those of our State. We note further that any claimed preemption of state laws is likely to be challenged and it may be some years before the question is finally resolved. The resulting uncertainty would not operate "in the public interest" or "for the protection of investors."

This issue is of acute interest to California business attorneys. As noted in Section II.C. below, California attorneys would be prohibited in most cases from complying with the "noisy withdrawal" component of the Proposed Rules as well as further portions of the Proposed Rules requiring disclosure to anyone other than the client itself. California attorneys could well find themselves obligated to challenge the Proposed Rules if they are ultimately adopted in their current form.

**C. THE PROPOSED RULES CONFLICT WITH CALIFORNIA ATTORNEYS' ETHICAL REQUIREMENTS**

Under Section 205.3(d)(i)(A) and (B) of proposed Rule 205, an attorney retained by the issuer who did not receive, within a reasonable time, an appropriate response to a report of evidence of a material violation, would (if the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors) be obligated not only to withdraw from representing the issuer, but also to notify the Commission in writing both of the withdrawal and the fact that such withdrawal is based on professional considerations. Under Section 205.3(d)(1)(i)(C), the attorney would also be required to disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document "that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading ...".

Were the Commission's proposals on noisy withdrawal and disaffirmance adopted, California counsel would be put in an untenable situation in those circumstances where they were called upon to comply with the withdrawal and disaffirmance mandates of Section 205.3(d). Members of the California bar are subject to the Rules of Professional Conduct of the State Bar of California, adopted by the State Bar's Board of Governors and approved by the California Supreme Court, and to the State Bar Act, Cal. Business & Professions Code § 6000 *et seq.* California's "reporting up" requirement is found in Rule of Professional Conduct 3-600 ("Rule 3-600"), discussing a member's responsibilities when representing "an organization." The relevant portion of Rule 3-600 provides:

"(B) If a member acting on behalf of an organization knows that an actual or apparent agent of the organization acts or intends or refuses to act in a manner that is or may be a violation of law reasonably imputable to the organization, or in a manner which is likely to result in substantial injury to the organization, the member shall not violate his or her duty of protecting all confidential information as provided in Business and Professions Code section 6068, subdivision (e). Subject to Business and Professions Code section 6068, subdivision (e), the member may take such actions as appear to the member to be in the best lawful interest of the organization. Such actions may include among others:

"(1) Urging reconsideration of the matter while explaining its likely consequences to the organization; or

"(2) Referring the matter to the next higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest internal authority that can act on behalf of the organization.

"(C) If, despite the member's actions in accordance with paragraph (B), the highest authority that can act on behalf of the organization insists upon action or a refusal to act that is a violation of law and is likely to result in substantial injury to the organization, *the member's response is limited to the member's right, and, where appropriate, duty to resign in accordance with rule 3-700* [emphasis added]."

While Rule 3-700 permits -- and in certain circumstances requires -- counsel to withdraw from employment under certain circumstances, including if a client "seeks to pursue an illegal course of conduct," it stipulates that a member "shall not withdraw from employment until the member has taken reasonable steps to avoid reasonably foreseeable prejudice to the rights of the client ...." In any event, the member's response is limited to withdrawal.

The general duties of California counsel are set forth in Section 6068 of the California Business and Professions Code. Section 6068(e) provides:

"It is the duty of an attorney to do all of the following: [...] (e) To maintain inviolate the confidence and at every peril to himself or herself to preserve the secrets, of his or her client."

Section 6068(e)'s admonition to counsel to maintain "at every peril to himself or herself" the confidences of counsel's client is symbolic of California's tradition of strictly and zealously protecting the attorney-client privilege. As observed by our Supreme Court, "[w]hile it is perhaps somewhat of a hyperbole to refer to the attorney-client privilege as 'sacred,' it is clearly one which our judicial system has carefully safeguarded with only a few specific exceptions." *Mitchell v. Superior Court*, 37 Cal. 3d 591, 600, 208 Cal. Rptr. 886 (1984) (footnote omitted).<sup>4</sup> In California, the privilege extends even to prohibiting a trial court from examining documents *in camera* to determine whether the privilege adheres to the document. Evidence Code § 915; *Southern California Gas Co. v. Public Utilities Commission*, 50 Cal. 3d 31, 45 n. 19, 265 Cal. Rptr. 801 (1990).<sup>5</sup>

#### **D. CREATING CONSISTENT AND CLEAR DUTIES FOR ISSUERS AND ATTORNEYS**

The "reporting up" requirements of Section 307 of the Act are consistent with the ethical obligations of attorneys under California Rule 3-600. An attorney's obligations under Rule 3-600 may arise in the context of the attorney acting either as an advisor or as an advocate. In each case, the attorney owes professional duties to the client, but the decision making authority with regard to the action the client takes after receiving the attorney's advice

resides with the client, as does the responsibility to make such decisions. The attorney is not permitted to disclose client confidences without the client's consent, as contemplated by the Proposed Rules, other than in extraordinary circumstances much narrower than the scope of the Proposed Rules and only as expressly permitted by California law.

The obligation to comply with the securities laws resides with the issuer. The text of Section 307 of the Act does not suggest that attorneys should become guarantors of their clients' securities law compliance, nor, as noted above, did Congress so intend. Section 307 does specifically intend that the highest levels of the issuer, if necessary, receive legal advice concerning what counsel believes to be a material violation of the securities laws, as part of the issuer's decision making process in complying with the securities laws. Once counsel has provided advice regarding the nature and extent of the issuer's securities laws duties, the ultimate obligation to comply with the securities laws continues to reside with the issuer.

The Commission staff developed, for purposes of the Proposed Rules, the concept of the QLCC, which would consist of independent members of the Board of Directors having the obligation and the authority to make securities law compliance investigations and decisions on behalf of an issuer. Under the Proposed Rules, an issuer that has constituted a QLCC will have full responsibility for matters referred to it by counsel; an attorney who has made a referral under Rule 205.3(c)(1) has no obligation to make a noisy withdrawal or disaffirm the issuer's filings.

The decisions and actions by the issuer concerning securities law compliance in the circumstances set out in Rule 205.3(c)(1) are the issuer's alone. This model (attorney advises, client decides and acts) is consistent with the text of Section 307 and attorneys' obligations under state law, and should be adopted as the basic model for all issuer and attorney relations in the final version of the rules under Section 307. It provides certainty to issuers and counsel concerning their respective duties, and fulfills the objectives of Section 307.

### **III. DISCUSSION OF SPECIFIC ELEMENTS OF PROPOSED RULES**

#### **A. IDENTITY OF CLIENT**

Under California law, an attorney who represents a corporation represents the entity, but does not thereby also represent the shareholders. This distinction is set out in Rule 3-600(A), (D) and (E), and was confirmed in *Brooklyn Navy Yard Cogeneration Partners, L.P. v. Superior Court*, 60 Cal. App. 4th 248, 254-255, 70 Cal. Rptr. 2d 419 (4th Dist. 1997) (under Rule 3-600 the client is the corporation, not its shareholders, acknowledging that the interest of the corporation, as counsel's client, can be adverse to those of its shareholders); *National Football League Properties, Inc. v. Superior Court*, 65 Cal. App. 4th 100, 107-108, 75 Cal. Rptr. 2d 895 (6th Dist. 1998) (attorney representing corporation does not become the representative of its shareholders); *Skarbrevik v. Cohen, England & Whitfield*, 231 Cal. App. 3d 692, 703-704, 282 Cal. Rptr. 627 (2d Dist. 1991).



We are concerned that Rule 205.3(a)'s reference to "act in the best interests of the issuer and its shareholders" is inconsistent with California law. The board of directors, as a matter of corporate law, is obligated to act in the best interests of the corporation and its shareholders. California Corporations Code §309(a). An attorney who disagreed with the board's decisions regarding the best interests of shareholders should not be authorized by Rule 205.3(a) to act on his or her own judgment in place of the client's -- *i.e.*, the board's -- directions. Moreover, the laws of many states extend fiduciary duties of directors in certain instances to take into account the interests of other constituencies, such as creditors. We do not believe Congress intended the Proposed Rules to override the substantive provisions of the law of California or other states as to the identity and nature of the client. As a result, we believe that the words "and its shareholders" should be dropped from Proposed Rule 205.3(a).

**B. "REPORTING UP" AND "REPORTING OUT"**

**1. "Reporting Out" Inhibits Effective Legal Counsel**

A significant objective of the "reporting up" elements of the Act was to bring increased scrutiny to controversial or close legal decisions. The Act achieves a very significant improvement in corporate governance by creating a structure in which executives and management of issuers will find it difficult, if not impossible, to keep their heads in the sand with respect to activities of their company or to foster an environment in which subordinates are encouraged or even expected to do likewise.

We believe, however, that the "reporting out" mechanisms established in the Proposed Rules could well put attorneys in the position of essentially being accusers of, rather than advisors to, clients. For that reason, the client may very well find it safer to avoid consulting counsel on close or controversial legal questions -- precisely the ones for which legal counsel can be most critical. Fundamental to the right to counsel is the right to effective legal counsel. In order to achieve that, courts have concluded that clients must not have the built-in disincentive of candor and openness with legal counsel potentially being used against the client.

Yet that is exactly what the Proposed Rules would accomplish. In that context, they are virtually certain to inhibit the effective provision of legal advice and counsel, which, by definition, will diminish the amount of information available to issuers by which they can assure compliance with the law.

**2. Conforming QLCC and Non-QLCC Reporting**

We are somewhat concerned about constituting a QLCC as a separate committee. Where economic competitiveness requires corporations to be more and more efficient at all

levels (operations and management), imposing another level of bureaucratic structure could be counterproductive. As a practical matter, more and more public companies are finding it very difficult even to identify and recruit qualified persons to serve as members of the Board of Directors and who are in fact independent of the management and the corporation itself.

We do see a benefit to having a body constituted within the corporate structure to serve as the ultimate authority on, and have ultimate responsibility for, securities compliance matters. And if the Commission insisted on adopting "noisy withdrawal" and disaffirmance rules at odds with California law, the QLCC proposal would help attorneys licensed to practice law in the State of California discharge their responsibilities under the Rules of Professional Conduct, assuming their clients chose to create such a committee since, as we understand it under the Proposed Rules, referring a matter to the QLLC eliminates any requirement for a "noisy withdrawal."

We believe, however, that the Proposed Rules should not distinguish between what would otherwise be seen as both normal and fully-compliant "reporting up" reporting for issuers which have a QLCC and those which do not. An attorney who brings a matter up-the-ladder to the entire Board should fully discharge his or her responsibilities under the Proposed Rules by doing so. Among other things, the independent members of that body certainly have the tools at that point to determine whether or not they wish to continue service in that capacity should the client fail to heed the advice of the attorneys. Once independent directors (or the entire Board) have been fully briefed regarding what the company's counsel has determined to be a material legal issue, the obligations of directors under state corporation law and under state and federal securities laws should provide -- and traditionally have provided -- adequate protection for the interests of investors. Moreover, that is achieved without conflicts which would result from exposing legal counsel to conflicting obligations under the Proposed Rules and state laws relating to client confidences.

### **3. "Noisy Withdrawal"**

We believe the final version of the Proposed Rules should not include the concept of "noisy withdrawal". As noted above (see Section II.C.), the obligation for an attorney to provide the notice specified in proposed Section 205.3(d) presents conflict with the obligations imposed upon attorneys subject to California's ethical standards. As also noted above, that will inevitably result in litigation and the uncertainty which accompanies it. It is also completely unnecessary in accomplishing the goal of Section 307.

### **4. Disaffirmance**

For the reasons just given, we believe the final version of the Proposed Rules should not include the concept of mandatory disaffirmance of filings when counsel has fulfilled

the "reporting up" requirements. Apart from issues relating to breaches of client confidences, the concept of "disaffirming" actual documents (or portions thereof) filed or submitted to the Commission or incorporated therein by reference also presents a problem of disclosure of client confidences without client consent.

## **5. Waiver**

Despite the text in the Proposed Rules at Rule 205.3(e) that certain disclosures will not constitute a breach of the attorney-client privilege and/or fiduciary duties owed to a client, such privileges and duties are created by state law jurisdictions. Whatever effect such provision of the Proposed Rules would have, it will be relevant only in the context of the proceedings with the Commission. Other tribunals and authorities will judge for themselves the effect outside of such proceedings. Moreover, assurances of the Commission in the Proposed Rules notwithstanding, attorneys are unlikely to take the chance that a communication by an attorney under the Proposed Rules does not constitute a waiver absent litigation and a final court determination to that effect.

By its nature, a waiver is a black or white matter. If the privilege is waived in one context, it may be deemed waived in all other contexts including those which are completely unrelated to the one in which the communication occurred. As a result, the issue of waiver is most likely to come up in the context of a suit not involving the Commission at all and not in the federal courts. When that occurs, the conduct of the attorney is certainly going to be scrutinized against the requirements of state law. The chances for inconsistent results are significant. None of that achieves the goals and purposes of Section 307 of the Act. In contrast, doing so is certain to invite controversy and litigation of a prolonged nature.

## **C. MANDATED DOCUMENTATION**

At various stages in the process of "reporting up" the Proposed Rules impose an obligation on the attorney to prepare what would effectively be called a "memorandum to the file." In many instances, an attorney may want to do that simply to preserve for the client and its counsel a record of deliberations. On the other hand, in some circumstances that may in fact not be consistent with the interests of the client and for that reason may be inappropriate. That determination is itself a matter of law and it would not be proper for the Commission to arrogate to itself the role of making that determination as de facto legal counsel to the issuer.

The purpose of the requirement is not at all clear from the Release or the Proposed Rules. By way of example, we recognize there may be some belief that preparation of such documents will by their nature be "outside the scope of employment" and as a result would not constitute to "attorney-work product." That could focus the inquiry on whether those documents were subject to compulsory discovery. We believe that any such assertion would

almost certainly be incorrect. In any event, we are quite confident in predicting that any such assertion would be met with significant and prolonged legal challenges.

It is also important to note that the process as envisioned in the Proposed Rules would occur at exactly the time when there was disagreement between an attorney and the client. At the very least, requiring the attorney to produce such product by virtue of his or her separate obligation to the Commission is bound to present potential for conflict of interest.

#### **IV. PROPOSALS**

For the reasons discussed above, we propose that the Commission make the following changes to the Proposed Rules prior to adopting them in final form:

##### **1. Discharge of Counsel's Duty, and "Noisy Withdrawal"**

We have noted above that there are conflicts between a California attorney's state law obligations to clients and the obligations established by the Proposed Rules. We believe that the existence of such conflicts will lead to challenges of the Proposed Rules, if they are adopted in their current form. We have noted that the specific "reporting up" requirements of Section 307 of the Act are directed at achieving legal disclosure at the highest independent level of decision making within an issuer, permitting those persons bound by fiduciary duties as directors to decide securities compliance issues. We have noted that the QLCC structure developed in the Proposed Rules includes the concept that a complete "reporting up" to the QLCC discharges the attorney's duties and no noisy withdrawal or disaffirmance of client filings is required.

To achieve certainty for both issuers and their counsel, the Proposed Rules, in their final form, should include the concept that an attorney has discharged his or her duties under Rule 205 by "reporting up" to either the QLCC *or the entire board*, and that no mandatory disaffirmance or noisy withdrawal obligations be imposed.

##### **2. Waiver**

The language at Rule 205.3(e)(3) should be withdrawn.

##### **3. Disaffirmance**

The language at Rule 205.3(d) relating to disaffirmance should be amended to withdraw references to mandatory disaffirmance.

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

**SUBMITTED BY E-MAIL**

**4. Identity of Client**

The words "and its shareholders" should be withdrawn from Rule 205.3(a).

---

We hope the foregoing is useful to the Commission and Staff in considering appropriate modifications to the proposed Rules under Section 307 of the Sarbanes-Oxley Act of

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

**SUBMITTED BY E-MAIL**

2002, prior to adoption of final Rules. Please do not hesitate to contact either of the undersigned if you have any questions on the matters raised herein.

Very truly yours,

/s/  
Timothy G. Hoxie  
Chair, Business Law Section

/s/  
Keith Paul Bishop  
Co-Chair, Corporations Committee

/s/  
Bruce Dravis  
Co-Chair, Corporations Committee

Drafting Committee:

Keith Paul Bishop, Esq.  
Irell & Manella LLP  
840 Newport Center Drive  
Suite 400  
Newport Beach, CA 92660  
(949) 760-0991  
[kbishop@irell.com](mailto:kbishop@irell.com)

Bruce Dravis, Esq.  
Downey, Brand, Seymour & Rohwer, LLP  
555 Capitol Mall  
Tenth Floor  
Sacramento, CA 95814  
(916) 441-0131  
[bdravis@dbsr.com](mailto:bdravis@dbsr.com)

James F. Fotenos, Esq.  
Greene, Radovsky, Maloney & Share LLP  
Four Embarcadero Center  
Suite 4000  
San Francisco, CA 94111  
(415) 981-1400  
[jfotenos@grmslaw.com](mailto:jfotenos@grmslaw.com)

Steven K. Hazen, Esq.  
Kelley, Drye & Warren LLP  
777 South Figueroa Street  
Suite 2700  
Los Angeles, CA 90017  
(213) 689-1300  
[skhazen@kelleydrye.com](mailto:skhazen@kelleydrye.com)

Cc: Charles L. Crouch III, Esq.  
Vice Chair, Business Law Section

Jerome A. Grossman, Esq.  
Vice-Chair, Business Law Section

Elaine Leadlove-Plant, Esq.  
Secretary, Business Law Section

Ms. Susan M. Orloff  
Business Law Section Administrator

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

**SUBMITTED BY E-MAIL**

**The State Bar of California Business Law Section  
Corporations Committee Members**

As of the date of this letter, the Corporations Committee is composed of the members shown below, not all of whom necessarily endorse each and every recommendation and view expressed in this letter. Taken as a whole, however, this letter reflects a consensus of the members of the Corporations Committee.

Keith Paul Bishop, Co-Chair  
Bruce Dravis, Co-Chair  
Nancy Wojtas, Vice-Chair, Legislation  
David M. Pike, Vice-Chair, Education  
Brian D. McAllister, Vice-Chair, Communications  
James K. Dyer, Secretary  
Curt C. Barwick  
John C. Carpenter  
Nelson D. Crandall  
Teri Shugart Erickson  
Timothy J. Fitzpatrick  
James F. Fotenos  
Steven K. Hazen

Mark T. Hiraide  
Victor Hsu  
John H. Marlow  
B. Keith Martin  
Stewart Laughlin McDowell  
Ethna M.S. Piazza  
Cynthia Ribas  
Randall Brent Schai  
James R. Walther  
Daniel J. Weiser  
Neil J Wertlieb  
Brian M. Wong

**NOTES**

- 1 The text of the Proposed Rules does not itself use that terminology. The term is, of course, used in the Release and was used in the public hearing of the Commission pursuant to which the Release was authorized. In that context, it appears to have achieved relatively wide recognition. Nonetheless, we do point out that the terminology itself may contribute to ambiguity as to what actions are intended and what goals are ostensibly served by it.
- 2 We note that attorneys can have obligations to withdraw from representation of a client to prevent giving further assistance to the commission of fraud or other crime, and may in such circumstances be obligated to disaffirm materials prepared by the attorney on which third parties may rely. The Proposed Rules require "reporting out" in less extreme circumstances.
- 3 It is beyond the scope of this letter to present a legal brief on why any such claim of preemption would fail, and for that reason we do not address the issue directly. In acknowledging the potential conflict between its proposal and state ethics codes, the Commission states, in proposed Rule 205.1, that where "the standards of a state where an attorney is admitted or practices conflict with his part, this part shall govern." In light of

the legislative history of Section 307, there is reason to doubt the existence of a clearly manifested Congressional intent to give the Commission authority to mandate a noisy withdrawal or disaffirmance of filings as proposed in Rule 205.3(d).

- 4 The attorney-client privilege applies to corporations, and the privilege extends beyond matters discussed in contemplation of litigation. *Hoiles v. Superior Court*, 157 Cal. App. 3d 1192, 1198, 204 Cal. Rptr. 111 (4th Dist. 1984).
- 5 That the prohibition on revealing client confidences is strictly observed was confirmed by our Supreme Court in *General Dynamics Corp. v. Superior Court*, 7 Cal. 4th 1164, 32 Cal. Rptr. 2d 1 (1994). At issue in this case was whether an in-house counsel could sue his employer for wrongful termination. Counsel alleged that the termination violated an implied contract, and that he was terminated for reasons which violated fundamental public policies. The Court concluded that counsel could sue for breach of an implied contract, and could, to the same extent as any other non-attorney employee, sue on the grounds that his termination violated fundamental public policies, as long as, by his action, counsel did not disclose client confidences, other than as strictly permitted by the Rules of Professional Conduct or statute:

"... the in-house attorney who publicly exposes the client's secrets will usually find no sanctuary in the courts. Except in those rare instances when disclosure is explicitly permitted or mandated by an ethics code provision or statute, it is never the business of the lawyer to disclose publicly the secrets of the client."

7 Cal. 4th at 1190.

Further evidence of the narrow construction given to a claimed exemption from the requirement to maintain client confidences is found in *Solin v. O'Melveny & Myers, LLP*, 89 Cal. App. 4th 451, 107 Cal. Rptr. 456 (2d Dist. 2001). In September, California Governor Gray Davis confirmed the importance in California of the duty of counsel to maintain client confidences by his veto of AB 363, a bill that passed the California Legislature on August 28, 2002. That bill would have amended the Business and Professions Code to permit attorneys representing governmental organizations to report improper governmental activity to the "law enforcement agency charged with responsibility over the matter or to any other governmental agency or official charged with overseeing or regulating the matter..." if certain conditions were satisfied. By his veto message dated September 30, 2002, the Governor stated:

"While this bill is well intended, it chips away at the attorney-client relationship which is intended to foster candor between an attorney and client. It is critical that clients know that they can disclose in confidence



Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
December 16, 2002

**SUBMITTED BY E-MAIL**

so they can receive appropriate advice from counsel. The effective operation of our legal system depends on the fundamental duty of confidentiality owed by lawyers to their clients."